

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

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FEDERAL COMMUNICATIONS COMMISSION  
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Petition of US West Communications, Inc.	)	
For Forbearance from Regulation	)	CC Docket No. 98-157
as a Dominant Carrier in the	)	
Phoenix, Arizona MSA	)	
_____	)	

**OPPOSITION OF SPRINT CORPORATION**

Sprint Corporation (Sprint) respectfully submits its opposition to the above-captioned Petition filed by US West Communications, Inc. (US West).<sup>1</sup>

**I. INTRODUCTION AND SUMMARY**

US West seeks forbearance under Section 10 of the Communications Act of 1934, as amended,<sup>2</sup> from dominant carrier regulation in the provision of high capacity services in the Phoenix Metropolitan Statistical Area (MSA).<sup>3</sup> US West claims that forbearance is in the public interest in this case because it no longer has market power in the provision of high-capacity facilities (defined as DS1 and above) in the Phoenix MSA; that the market for such facilities has become "robustly competitive"; and, that it faces competition in providing such facilities from "... five established facilities-based competitors with substantial resources and extensive fiber networks" (US West Petition at iii).

US West's request for forbearance should be denied. As explained in more detail below, US West retains market power even in the self-selected, high-capacity facilities market within

<sup>1</sup> *Petition of US West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix Arizona MSA*, CC Docket No. 98-157 (filed August 24, 1998) (Petition).

<sup>2</sup> 47 USC § 10.

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the Phoenix area. Thus, by its own admission, US West still provides more than three quarters of the high-capacity facilities in the Phoenix MSA. And, although the studies relied upon by US West are too incomplete to permit real precision, it may well be that in terms of the revenues derived from the sale of such facilities, US West's share may be substantially greater. Moreover, these facilities are essential inputs used in important downstream service markets (namely, local service and exchange access) where US West retains a near monopoly. The need to integrate high-capacity facilities with US West's local network (so that competitors can use these facilities to reach the vast majority of customers taking local service in the Phoenix MSA) results in a bottleneck which US West can use against competing providers of high-capacity facilities by degrading the service of these rivals, by raising their costs, or by otherwise engaging in discrimination both blatant and subtle.

There is, in any case, no need for the relief urged by US West. The Commission's "zone density rules" already grant US West substantial flexibility in pricing high-capacity facilities not only in Phoenix, but throughout its service territory. If US West feels threatened by competition in Phoenix in the sale of high-capacity facilities, it can lower its prices for these facilities to contest its competitors so long as it undertakes the same reduction in other areas of equivalent density and, presumably, equivalent costs. US West may also make its high capacity facilities available pursuant to term and volume discounts. To allow US West additional flexibility is likely to result in anticompetitive ramifications. It will allow US West to segment its markets and lower prices only where it has come under competitive pressure. It will be able to continue to receive monopoly rents from users that have similar price characteristics, but where competition has not yet arrived, and use these supranormal profits to subsidize service in more competitive areas.

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<sup>3</sup> *Id.*, at 1.

The problem of such cross-subsidization is hardly a remote threat. US West provides high capacity facilities, local service and exchange access on a vertically and horizontally integrated basis. Accounting constraints are hardly adequate to prevent US West from raising prices to monopoly users and then using these increases to "subsidize" its sales of high-capacity facilities. US West may even be able to lower its prices for high capacity facilities below its applicable costs. Price caps may be helpful in preventing such behavior but they are hardly a panacea. Both this Commission and State regulatory agencies continue to carefully monitor the returns of local carriers and "costless predation" is still a viable business strategy.

**II. THE COMMISSION SHOULD CAREFULLY CONSIDER WHETHER IT IS IN THE PUBLIC INTEREST FOR IT TO RULE ON REQUESTS FOR FORBEARANCE FROM DOMINANT CARRIER REGULATION ON A CITY-BY-CITY, PRODUCT-BY-PRODUCT AND SERVICE-BY-SERVICE BASIS**

As noted US West already has substantial pricing flexibility. There can be no serious argument that it is so burdened by existing regulation that it will be unable to compete fairly against emerging competition for high-capacity facilities. US West does not claim that there is anything unique about the Phoenix MSA that would allow competition for high capacity facilities to develop there but not in other major cities or comparable centers of population density. On the contrary, its filing repeatedly suggests that Phoenix is quite typical and that the competitors that it faces there operate nationwide or at least in other major cities.

While US West goes to great lengths to pattern its petition after that of AT&T's,<sup>4</sup> the fact remains that AT&T's Motion covered a substantially larger scale and scope of services. In the *AT&T Domestic Non-Dominance Order*, the Commission agreed with AT&T that the relevant market should be defined as all interstate, domestic interexchange services.<sup>5</sup> Such a market

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<sup>4</sup> *Motion for Reclassification of American Telephone and Telegraph Company as a Non-Dominant Carrier*, CC Docket No. 79-252, filed September 22, 1994; see also *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, Order, 11 FCC Rcd 3271 (1995) (*AT&T Domestic Non-dominance Order*).

<sup>5</sup> *AT&T Domestic Non-dominance Order* at ¶ 21.

essentially encompassed all of AT&T's services, except international services. After a careful analysis of all of the relevant services offered in the defined market, the Commission determined that while AT&T possessed market power with respect to a few discrete services, it lacked market power in the overall nationwide interstate, domestic interexchange market.<sup>6</sup>

In contrast, US West seeks non-dominant regulatory treatment for its narrowly-defined offering in one small geographical area, the Phoenix MSA. US West's attempt to obtain piecemeal regulatory reclassification is an opportunistic and misguided effort, which will create for the Commission and all other interested parties a procedural morass that will needlessly suck up enormous resources.

In addition, granting petitions such as US West's on a piecemeal basis would also inevitably lead to inconsistencies. Each petition would require an in-depth, fact-intensive competitive analysis for each service offered in small geographical areas. Small differences in the factual circumstances surrounding the provision of services in each narrow geographical area would, in all likelihood, give rise to inconsistent rulings. The Commission would be engaged in making increasingly narrow distinctions and determinations concerning small market segments in smaller and smaller geographical areas. Ultimately the Commission's analytical exercises would resemble that of the proverbial medieval monks who would debate how many angels can fit on the head of a pin. The probability of inconsistent rulings would increase as the product and geographical markets become smaller. As a result, the Commission should make clear that it will not rule on a petition for non-dominance such as US West's unless it covers a wider range of products and services, such as all residential or business local access services in a state or entire BOC region.

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<sup>6</sup> *Id.*, at ¶ 39.

### **III. US WEST RETAINS MARKET POWER IN THE HIGH CAPACITY FACILITIES MARKET**

#### **A. US West controls bottleneck local exchange and exchange access services**

High capacity circuits are used by some carriers and end users in order to provide local exchange and exchange access services. As such, these dedicated circuits constitute an essential input for a defined set of customers. US West contends that this upstream market exhibits indicia of competition and therefore the Commission should not regulate it as dominant for this market. However, US West continues to maintain a virtual monopoly in the non-competitive downstream markets of local exchange and exchange access services. As a result, US West can, absent dominant carrier regulation, exercise its downstream market power to the detriment of consumers and providers of dedicated circuits.

US West has both the ability and the incentive to exercise its bottleneck control over its local exchange and exchange access services in order to harm competition in the dedicated circuits market. Any choice that carriers or end users may have over the supplier of dedicated circuits would be undermined by US West's ability to act anticompetitively. For example, US West could charge higher interconnection fees or degrade the quality of interconnection to those customers who subscribe to competitive dedicated circuit providers. Because dedicated circuit subscribers have no choice but to subscribe to US West's local exchange and exchange access services, they will not be able to respond to this type of anticompetitive conduct. Rather, they would have only the choice of keeping their dedicated circuit provider and accepting higher priced or lower quality local services, or switch to US West for their dedicated circuit needs. Until US West opens its local markets to competition, the Commission must maintain dominant carrier regulation over US West's provision of high capacity facilities.

**B. Absent dominant carrier regulation, US West can cross-subsidize its provision of dedicated circuits.**

In addition to maintaining monopoly power over local exchange and exchange access services, US West also has bottleneck control over adjacent inputs that are essential for the provision of local services. For example, US West has bottleneck control over interconnection and local switching services in the Phoenix area. US West could raise its charges for these services and use the additional revenues to cross-subsidize its dedicated circuit offerings. In doing so, US West would at least be able to harm competitive providers of high capacity facilities and conceivably be able to drive them out of the market entirely. Without continued monitoring by the Commission and state regulatory agencies of the rates of return earned by local carriers, there is a strong possibility that US West will be able to price high capacity facilities below its associated costs or to shift costs properly allocated to those facilities to other, less competitive services. Neither accounting regulation nor price caps provide any guarantee against such anticompetitive behavior. In order to help prevent US West from engaging in cross-subsidization, the Commission must continue to require US West to file tariffs and cost support for its provision of dedicated circuits.

**C. US West maintains very high market share in each of the relevant markets.**

Perhaps the most obvious indication of US West's dominance is its market shares for the markets it purports to have identified. First, in the putative overall high capacity circuits market (which includes high capacity provider and transport circuits), US West admits that it maintains a 77 percent market share. Such a high market share indicates that this market segment is highly concentrated and that US West, with the overwhelming market share, maintains market power.<sup>7</sup> Similarly, US West maintains a 72 percent market share of the provider circuits market, which is

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<sup>7</sup> Petition at Attachment A, p. 12. Thus, the overall market would have a minimum Herfindahl-Hirschman Index (HHI) value of 6033, with US West's share equaling 5929. This indicates that this market is highly concentrated and that US West has probable market power.

another strong indicator of market power over this essential input.<sup>8</sup> Finally, US West maintains an 84 percent market share of the transport market, indicating that this too is a highly concentrated market with US West as the clear dominant carrier.<sup>9</sup>

Even the manner in which US West calculated these figures, however, is unclear. Although US West's consultant, Quality Strategies, provides a general explanation of its methodology, it is impossible to ascertain how various important factors were considered in deriving the market share figures cited. For example, Quality Strategies says that market share was calculated using DS-1 equivalents, presumably from its "Competitor Capacity" chart. But it appears that the "Approximate Percentage Operating at that Speed" line includes dark fiber as well as revenue generating circuits. Even if a particular fiber pair is lit and operational, some circuits may not be generating revenue. And because it is impossible to light less than one fiber pair, it is entirely possible for there to be only a single paying DS-3 customer on that fiber pair.

The best comparison for market share purposes would probably be high capacity circuit revenues, for this would allow the comparison of paying customers. The instant methodology does not permit such a comparison, and its focus on capacity artificially<sup>10</sup> inflates the market share (and threat) of US West's putative competitors. In addition, because US West does not include the raw data on which the market share calculations were based, there is no way for the Commission (or any other interested parties) to judge the validity of the analysis. Until US West

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<sup>8</sup> *Id.*, at p. 13. The minimum HHI value for this market (5340.8) again demonstrates that this market is highly concentrated, with US West maintaining a highly dominant position (it has an HHI value of 5184).

<sup>9</sup> *Id.*, at p. 14. This market exhibits a minimum HHI value of 7107.2 with US West's share amounting to 7056.

<sup>10</sup> The tremendous advances in laser technology allow increasingly greater amounts of throughput to be sent over a single fiber, and no new entrant installs only one or two fiber pairs on a route when the marginal costs of installing additional capacity is close to nil. A new competitor will by definition enter the market with zero market share even though it has enormous spare capacity.

makes this raw data available, the Commission should ascribe little weight to the market share report.

Sprint notes that even the near 80 percent market share figures cited by US West may be understated. The Quality Strategies High Capacity Phoenix Market Study, which was appended to US West's petition, notes that market share was based upon DS-1 equivalents. One DS-3 (45 Mbps) circuit is counted as 28 DS-1 circuits. While this relationship may make sense from an engineering standpoint, Sprint notes that a DS-3 circuit is not 28 times as expensive as a DS-1 circuit. Thus, customers will order DS-3 service even if they do not need all of the capacity available in the DS-3. If a carrier has a customer mix that is more heavily weighted towards DS-1 rather than DS-3 customers, that carrier will derive greater revenue per DS-1 equivalent than a carrier whose customer mix leans more towards DS-3 customers. This is so even though the nominal amount of DS-1 equivalent circuits provided by both carriers is identical. If, as seems likely, US West has a higher proportion of DS-1 customers generally than its competitors because of the greater ubiquity of its facilities, it will have a disproportionately greater share of high capacity revenues because of this mix.<sup>11</sup>

In the putative retail market,<sup>12</sup> US West states that it has only a 29.2 percent market share.<sup>13</sup> However, US West by its own admission provisions almost 80 percent of all high capacity circuits even though it has a billing relationship for only 30 percent of these circuits. It is not clear what comfort US West derives from the fact that there is a "secondary" or "resale" market for high capacity facilities. US West does not participate in this secondary market. Rather, it sells the high capacity facilities which it, not the reselling carriers, provides. It is in the

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<sup>11</sup> This intuitive inference is buttressed by the chart on US West and Competitor 4Q97 shares for the Provider Market contained in page 13 of the Quality Strategies study, which shows that US West had a greater proportion of DS-1 customers vs. DS-3 customers than its competitors.

<sup>12</sup> The retail market consists of carriers who sell switched access and high-capacity services to end users directly.

<sup>13</sup> Petition at Attachment A, p. 17.



high capacity facilities market where US West seeks to be declared non-dominant based on its claims that it no longer possesses market power. US West's share of this market is, of course, critical to its assertion of non-dominance.

The existence of a secondary market for such facilities is irrelevant. For example, if US West had 100 percent of the market for high capacity facilities, it would have complete control of this facilities market. And, this would be true regardless of whether a lively secondary market for such facilities existed or not.

As explained by the court in *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986), *cert. den.* 479 U.S. 1033 (1987) at 221, "[t]he degree of intrabrand competition is wholly independent of the level of interbrand competition confronting the manufacturer. Thus, there may be fierce intrabrand competition among the distributors of a product produced by a monopolist and no intrabrand competition among the distributors of a product produced by a firm in a highly competitive industry. But when interbrand competition exists, ... it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." Because US West actually provides 70% of the circuits even though it may not bill them, the possibilities of facilities-based competition (and the competitive check such competition provides) are limited. For this reason, the Commission should be slow to attach significance to US West's 29.2% figure.

Moreover, US West's claims that it is rapidly losing market share ring hollow in view of the substantial changes that are likely forthcoming in access charges. Demand for high capacity circuits is greatly affected by the pricing of switched vs. special access service under the current access charge regime. The Commission has already identified the usage sensitive carrier common line (CCL) rate structure as "an economically inefficient cost recovery mechanism and

implicit subsidy."<sup>14</sup> As the Commission is well aware, this usage sensitive rate structure results in larger users overpaying for access, driving many of them to avoid switched access fees by substituting high capacity service linking them directly with interexchange carriers ("bypass").

As the Commission reforms its interstate access charge regime, it is clear that the subsidies inherent in the current CCL rate element will diminish, rendering the bypass of switched access through high capacity services much less attractive. As a result, the market for high capacity services is likely to shrink and some providers may exit the market. For US West to assume that its past loss of market share will continue unabated in the future is overly simplistic and ignores the likely effect of forthcoming regulatory actions.

US West also mistakenly claims that because existing competitors have significant amounts of fiber in the ground in the Phoenix area, they could "absorb a majority of US West's high capacity demand almost immediately."<sup>15</sup> The fact that US West's competitors may have fiber in the ground does not equate to the ability to absorb US West's high capacity demand "immediately." Sprint has considerable experience with use of alternate providers of high capacity. It speaks from experience in stating that it is complicated and expensive to shift from an incumbent LEC's high capacity circuits onto those of an alternate provider. In order to minimize potential interruptions to customers and maintain quality, such cutovers do not occur with the push of a button.

For example, individual Sprint customer circuits are manually "rolled" one by one from the ILEC to the alternate provider, usually at night when traffic is minimal. Sprint must pay both its and the ILEC's personnel overtime wages to perform this task. Moreover, the testing necessary to ensure end-to-end quality and continuity of the circuit usually requires the

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<sup>14</sup> Access Charge Reform, First Report and Order, 12 FCC Rcd 15982 (1997), *recon. pending, aff'd in part sub nom. Southwestern Bell v. FCC*, Case No. 97-2618, Eighth Circuit, August 19, 1998.

<sup>15</sup> Petition at 27.

involvement of the alternate provider in addition to the ILEC and Sprint, complicating this task significantly.

For the above reasons, the Commission should find that US West maintains market power in the high capacity facilities market and should remain subject to dominant carrier regulation.

**IV. THERE IS NO NEED FOR FORBEARANCE: US WEST ALREADY HAS SUFFICIENT PRICING FLEXIBILITY TO ALLOW IT TO COMPETE EFFECTIVELY IN THE HIGH CAPACITY SERVICES RETAIL MARKET**

Under Section 69.123 of the Commission's rules,<sup>16</sup> independent local carriers may establish density pricing zones for special access and switched transport services. Within these zones, carriers are allowed to charge different rates for special access services.<sup>17</sup> Thus, US West may price its special access services provided in high density areas such as Phoenix at lower rates than it provides such services in rural areas. This rule enables US West to respond to incipient competition in urban areas by lowering its prices in these pricing zones.

US West complains that it cannot compete effectively because Section 69.123 requires that it must maintain uniform pricing for each density pricing zone within a study area.<sup>18</sup> Essentially, US West is complaining that in order to lower the price of its high capacity services in Phoenix, it would also have to lower the price of those services in other density pricing zones in the Arizona study area. Of course, because US West does not face the same degree of competition outside of Phoenix, it would like to maintain the above-cost rates it is able to charge in the non-competitive areas. The Commission need not show US West any compassion for its upper class problem. If US West needs to compete more effectively in Phoenix, it can, under

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<sup>16</sup> 47 C.F.R. § 69.123

<sup>17</sup> 47 C.F.R. § 69.123(c)

<sup>18</sup> Petition at note 19; *see also* 47 C.F.R. § 69.123(a).

section 69.123, solve its "dilemma" by reducing its prices for high capacity services throughout all of its density pricing zones in the Arizona study area. It would certainly not be in the public interest for the Commission to enable US West to segment the market by continuing to charge above-cost rates for its high capacity services in areas outside of Phoenix by forbearing from regulating US West as a dominant carrier within Phoenix.

The Commission's Zone Density Pricing rules provide a far better accommodation between the need for the Commission to allow some pricing flexibility in markets where nascent competition is pressuring existing carriers to lower rates and the need to prevent incumbents from harming competition by selectively lowering prices. Because US West provides high-capacity facilities on an integrated basis with its monopoly local exchange and exchange access services, there is a palpable threat of cross-subsidization. The threat of such discriminatory actions are at least eased if any price reduction must be made available to all customers with equivalent zone densities and, presumably, with equivalent costs. The benefits of competition are thereby spread to all similarly-situated customers, rather than being limited only to those customers that are directly targeted by competition.

In addition, US West can offer term and volume discounts on its high capacity services. Nothing in the Commission's rules forbids US West (or any other ILEC) from offering such discounts,<sup>19</sup> which should enable US West to compete fiercely in Phoenix's high capacity circuit market. US West's status as an incumbent with by far the majority of installed facilities in

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<sup>19</sup> Of course, any discounts offered must be cost-based and not reliant on cross-subsidies from other services.

Phoenix should allow it to offer term and volume discounts that would be difficult for its new competitors to match.<sup>20</sup>

#### **V. US WEST SHOULD OPEN ITS LOCAL MARKETS TO COMPETITION**

Finally, US West complains throughout its Petition that it cannot compete as effectively as its competitors because US West alone is prohibited from bundling in-region, interLATA services with its high capacity services offerings.<sup>21</sup> US West cites the Communications Act's interLATA restrictions as support for its request for non-dominance. But as should be obvious, US West does not need non-dominant carrier regulation in order to compete more effectively against its rivals. Rather, US West need only comply with the requirements spelled out in section 271 of the Communications Act.<sup>22</sup> If US West needs to offer bundled services in order to

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<sup>20</sup> There are obviously substantial scale economies associated with the provision of high-capacity facilities. Because fiber must be buried, the construction of a single fiber route is relatively expensive. On the other hand, increasing the capacity of that fiber route becomes progressively less costly. Thus, on a circuit basis it is far cheaper to add a fiber line that carries thirty DS3s worth of traffic than to build a system that carries one DS3 or, conceivably, one DS1. US West's near monopoly provision of both local service and exchange access provides it with traffic flows that its competitors cannot yet begin to match.

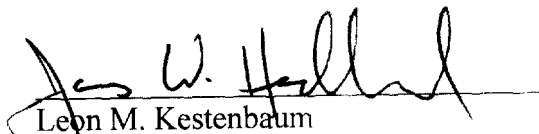
<sup>21</sup> See e.g., Petition at 20 ("resellers enjoy a significant competitive advantage over US WEST because of their ability to offer a full service package that includes interLATA services"); 25 ("so long as US WEST remains subject to the prohibition in offering interLATA services, the ability of competitive providers to offer a complete package of telecommunications services which includes interLATA voice and data services gives them a 'great advantage' over US WEST in the marketplace"); 40 (the social costs of dominant carrier regulation are compounded by the fact that US WEST is prohibited from responding to providers' bundled offerings, which may include interLATA voice and data services).

<sup>22</sup> 47 USC § 271.

compete against its rivals, then it should open its local markets to competition. On the other hand, granting US West's petition would reduce US West's incentives to open the local market in Phoenix.

Respectfully submitted,

SPRINT CORPORATION



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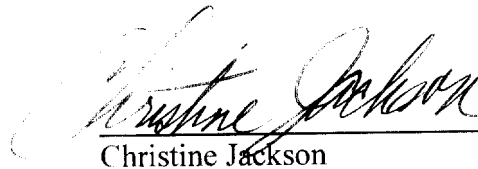
## CERTIFICATE OF SERVICE

I certify that a copy of the foregoing **Opposition of Sprint Corporation** was sent by hand or by United States first-class mail, postage prepaid, on this the 7<sup>th</sup> day of October, 1998 to the below-listed parties:

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